Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
BellSouth Telecommunications, Inc.	)	WC Docket No. 02-304
Tariff FCC No. 1, Transmittal No. 657	)	

DIRECT CASE

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Date: October 10, 2002

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In accordance with the Order released September 18, 2002, BellSouth Telecommunications Inc., ("BellSouth") hereby submits its Direct Case responding to the issues designated for investigation in connection with BellSouth's Transmittal No. 657.

I. INTRODUCTION AND SUMMARY

1. On July 19, 2002, BellSouth filed Transmittal No. 657 that proposed modifications to the deposit provisions of BellSouth's interstate access tariff. On August 2, 2002, the Commission suspended the transmittal for five months and initiated an investigation.

2. Among other things, the proposed revisions would permit BellSouth to request deposits from both new and existing access customers who were determined not to be creditworthy. A customer's creditworthiness, *i.e.*, the estimate of a customer's ability to make payments in the future for service rendered, would be determined by the application of commercially acceptable credit scoring tools.

3. Essentially, BellSouth's tariff revision would implement credit practices that are prevalent throughout American industry, including the telecommunications industry. BellSouth,

unlike competitive local exchange carriers and interexchange carriers or other firms extending credit, cannot unilaterally change the terms by which it extends credit to its customers.

4. The deposit provisions have not changed since interstate access tariffs were initially filed in the 1980's. This fact not only provided a reason to justify their amendment, but also serves to explain the objection to BellSouth's proposed changes. The existing deposit provisions do not reflect reasonable credit management principles, which should not come as a startling revelation. The deposit provisions were crafted in a rate-of-return environment where local and exchange access services were provided in a monopoly environment and a single carrier dominated the provision of interexchange service. There was little volatility in the telecommunications industry as whole and very little risk in providing access service.

5. A result of the stable market structure of the 1980's was limited exposure to bad debt. Furthermore, the limited exposure was complimented by a ratemaking philosophy that made paying customers responsible for the bad debts of nonpaying customers. The practicality of such an approach only extends to a noncompetitive, stable market environment.

6. The telecommunications market of the 1980's no longer exists. The Telecommunications Act of 1996 opened local exchange markets to competition. The interexchange market has experienced considerable instability. There has been a total transformation of the telecommunications industry. The relatively stable, low-risk industry has been replaced by a high risk, highly volatile industry.

7. The implosion of the telecommunications industry is well documented.[1] From its high point, shareholder value has decreased by $1.4 trillion. Layoffs in the telecommunications industry have exceeded all industries in nine of the last 12 months and, since 2000, have exceeded 600,000 employees. Further, the industry has witnessed over 80 bankruptcies since January 2000.[2]

8. In this changed market, BellSouth cannot be expected to continue to extend credit as if it were a monopoly, rate-of-return based common carrier. Even if market conditions were not as volatile as they currently are, the competitive environment mandates that commercially reasonable credit provisions replace the existing deposit provisions. To leave the existing provisions in place puts the risk of default of BellSouth's competitors upon BellSouth's shareholders. Not only is such a result competitively perverse, but it is also inconsistent with the objectives of the Telecommunications Act of 1996.

9. BellSouth should be permitted to make the same type of credit evaluation that any other firm makes before it extends credit to a customer. Whether a customer should be required to make a deposit should be dependent upon its ability to make payments in the future, not on whether the customer has made payments in the past. Indeed, the rash of telecommunications bankruptcies, including the second largest interexchange carrier, demonstrates unequivocally that

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1 *See, e.g., The Telecom Depression: When Will It End?*, Business Week, Oct. 7, 2002, at 66.

2 *See* BellSouth *Ex Parte* presentation in CC Docket No. 01-338, September 16, 2002.

the absence of a late payment history is not the sole determinant of a customer's financial condition and its ability to make future payments.

10. The current market volatility underscores both the need and appropriateness of BellSouth's deposit revisions. As the data BellSouth submits with this direct case show, its uncollectibles have increased dramatically and are well beyond the levels that were captured when price cap regulation was instituted. Further, the deposit provisions proposed by BellSouth are far less draconian than would be the case of shortening billing cycles and requiring advance payments for all services. BellSouth's deposit provisions allow for customers to meet their deposit obligations through non-cash substitutes. Such flexibility would not be present in the case of shortened billing cycles and advance payments. Moreover, such measures would clearly put pressure on the cash flow of the very access customers that have cash flow problems.

11. As shown in this Direct Case, BellSouth has reasonable terms and conditions surrounding its proposed deposit revisions. BellSouth will refund a cash deposit with interest or return the letter of credit or the surety bond when the customer's creditworthiness indicates a deposit is no longer necessary. BellSouth will review the creditworthiness of its customers every year. The tariff, however, enables the customer to request a deposit refund at any time. Upon such a request, BellSouth will review the customer's creditworthiness and, as appropriate, refund the deposit.

12. BellSouth's tariff also provides for an expedited dispute resolution mechanism.[3] As discussed below, the mechanism is reasonable because it affords customers a means to challenge BellSouth's request for a deposit. During the challenge, the customer can withhold payment of the deposit. Because BellSouth is permitting the customer to withhold payment of the deposit, it is appropriate that the dispute resolution process be expedited. Further, to avoid frivolous disputes, it is appropriate that the losing party bear the cost of the dispute resolution process. Thus, BellSouth's dispute resolution provision reasonably balances the interests of BellSouth and the access customer.

13. To the extent the Commission is concerned that BellSouth's long-term pricing plans or contract tariffs preclude the deposit provisions from taking effect, BellSouth demonstrates below that neither is a bar to the new provisions. Neither the deposit provision nor any other general regulation are part of the long-term pricing plans that BellSouth has in effect in its interstate access tariff. To the extent that the contract tariffs include references to the deposit provisions, modification of the deposit provision in the first instance does not constitute a material change that requires a showing of substantial cause. Even if such modifications were material, the Direct Case shows that BellSouth has substantial cause to make the change.

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[3] The essential predicate of an alternative dispute resolution mechanism is the establishment of a deposit provision that is based on commercially reasonable credit scoring techniques. If the Commission were not to permit the introduction of BellSouth's proposed deposit provisions, then an alternative dispute resolution mechanism would not be necessary.

14. In summary, this Direct Case makes abundantly clear that BellSouth's deposit provisions are just and reasonable. The telecommunications market has changed, and BellSouth merely conformed its tariff to prevailing competitive conditions.

II. ISSUES DESIGNATED FOR INVESTIGATION

A. Basis For Requiring A Deposit From A Customer

15. When BellSouth provides exchange access services, it may extend credit to a subscriber because there may be a lag between the time BellSouth receives payment for the services it has rendered. The lag can arise in different ways. For some services, such as switched access service, a customer is not billed until after the service is rendered. In other cases, the service may be billed in advance, but payment may not be received by the payment due date (typically, a billing cycle is 30 days). In such cases, BellSouth continues to be obligated to provide service. Under its tariff, BellSouth may not disconnect the service of a nonpaying customer unless BellSouth first gives the customer 30 days notice that its payment is delinquent.[4] In these situations, BellSouth extends credit to its customers.[5]

16. In other commercial settings involving the delivery of goods prior to the receipt of payment, the seller secures the transaction through a security interest in the goods. Thus, the seller retains an interest in the goods that not only acts as security for the buyer's performance, but, in addition, in the event of the buyer's bankruptcy, the seller is protected. BellSouth,

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4 BellSouth Telecommunications Inc., Tariff F.C.C. No. 1, Section 2.1.8(B), 1st revised page 2-6 (effective Jan. 1, 1993).

5 In Exhibit 1, BellSouth identifies by service, those services that are billed in advance and those services that are billed in arrears. Exhibit 1 also provides the information requested in paragraph 12 of the Designation Order.

however, provides service – it does not sell goods. It cannot secure itself in the same way a seller of goods does. Instead, the deposit provisions, such as those at issue in this proceeding, define the parameters around which BellSouth will provide credit. Thus, BellSouth, in filing its revised deposit provisions, is acting no differently than any other commercial entity that extends credit to its customers.[6]

17. The Designation Order expresses the view that BellSouth's deposit revisions alter the balance between BellSouth and its interstate access customers with respect to the risks of nonpayment that was established in the 1980's when the first access tariffs were filed.[7] To the contrary, the deposit provisions restore balance. The market and the telecommunications industry have been substantially altered since the 1980's. With regard to the current climate, the defining event was the Telecommunications Act of 1996. With the Act's implementation came a tide of new telecommunications carriers, many of which became purchasers of interstate access. The new competitive paradigm brought with it market volatility. More than market risk, facts have shown that underlying the new competition were many questionable business decisions and practices that gave way to an unprecedented number of business failures. These business failures, together with the dubious circumstances that surround several of them, warrant a more commercially acceptable approach to the extension of credit to replace the current deposit

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6 Deposit provisions such as those filed by BellSouth and other credit mechanisms facilitate commercial transactions. Absent such credit arrangements, commerce would grind to a halt.

7 Designation Order ¶ 10.

provisions that were put into place in a regulatory environment dominated by rate of return and monopoly provision of local exchange services.[8]

18. The deposit provisions proposed by BellSouth do not eliminate BellSouth's exposure to uncollectibles. Even if BellSouth had commercially reasonable deposit provisions in place prior to the 1996 Act, BellSouth would still experience uncollectibles. The deposit provisions would limit BellSouth's exposure to unreasonable risks that arise due to a customer's financial condition that calls into question the customer's ability to make future payments.

19. Table 1, below, provides BellSouth's interstate access uncollectibles between 1990 and 2001:[9]

TABLE 1
($ 000)

Year	Amount	Year	Amount
1990	$ 7,229	1996	$28,405
1991	$ 8,992	1997	$38,295
1992	$ 8,541	1998	$16,628
1993	$ 4,574	1999	$14,361
1994	$12,689	2000	$31,189
1995	$13,472	2001	$67,982

For the year 2000, total uncollectibles were $190,890,000. In 2001, total uncollectibles jumped to $362,166,000. Through July, total uncollectibles for the year 2002 had already reached

8 Under the existing deposit provisions, BellSouth holds $16,292,704 in deposits for intrastate and interstate access. These deposits compare to monthly charges of $297,548,522 or 5.5 per cent of monthly revenues.

9 The Designation Order requested the uncollectibles amount included in initial price cap rates. The filing should have included an amount that approximated the 1990 interstate uncollectibles. Upon review, it was determined that the initial price cap rates only reflected an uncollectibles amount of $2,196, 000 or about one quarter of the amount that would have been included based on actual uncollectibles during the period from July, 1990 through June, 1991.

$302,979,000.[10] The Designation Order requested data on individual defaults grouped into five ranges. BellSouth could estimate individual defaults for the ranges requested by the Commission for its wholesale customers only using data it has on bankruptcies and bad debt write offs. This information is depicted in Table 2 below.

TABLE 2

CRIS and CABS Combined	**Number of Customers 2000**	**2000 Amts ('000s)**	**Number of Customers 2001**	**2001 Amts ('000s)**	**Number of Customers 2002**	**Jan-Jul 2002 Amts ('000s)**
Up to $500K*	Not available	$ 6,610	Not available	$ 25,992	Not available	$ 7,295
$500K-$1M	-	-	5	4,200	1	500
$1M-$5M	7	11,900	14	26,500	5	9,500
Greater than $5M	1	9,600	3	36,000	4	67,600
Totals		$ 28,110		$ 92,692		$ 84,895
* A breakout of uncollectibles under $500K is not available; therefore, the amounts for "Less than $250K" and "$250K-500K" were combined.						

20. As these data show, there is an increase in uncollectibles after the 1996 Act. More significantly, the uncollectibles have more than doubled between 1999 and 2000 and again between 2000 and 2001. The increases in uncollectibles track the upheaval within the telecommunications industry, and the increasing number of business failures during that time. The circumstances can hardly be characterized as reflective of normal business risks that are endogenous to price caps. Nevertheless, BellSouth is not seeking exogenous treatment of its uncollectibles amounts. Rather, as a service provider, BellSouth, through its proposed deposit

10 Total uncollectibles include amounts associated with interconnection agreements that BellSouth has entered into with other carriers.

provisions, seeks to limit to a reasonable level the amount of financial exposure because of its bad credit risks. As noted earlier, the fact that a customer provides BellSouth with a deposit under the revised provisions will not eliminate uncollectibles, even as to those customers. Moreover, ultimately deposits will either be refunded to the customer or will be used as payment for service provided by BellSouth. Accordingly, BellSouth's deposit provisions should have no impact on any price cap index.

21. Further, whether a service is billed in arrears or in advance does not alter the process by which BellSouth would determine whether a deposit is necessary. In determining whether a deposit is necessary, BellSouth is evaluating financial and other information that bears upon a customer's ability to make payments in the future. Given the time a customer has to pay its bill as well as the amount of time that must elapse before BellSouth can disconnect service, there is no reason to have a different deposit policy based on whether a service is billed in advance or arrears.[11]

22. The Designation Order questions whether other tariff changes, such as accelerated billing cycles and requiring advance payments on all services, could mitigate the need for deposits. Modifying existing billing processes present a significant additional cost to BellSouth. Before investigating the feasibility of such changes, BellSouth would have to have a reasonable

[11] For services billed in advance, a customer who defaults on his bill could receive at least two months service without paying before BellSouth could disconnect. If the customer seeks protection under the bankruptcy laws, BellSouth cannot disconnect service. As requested in the Designation Order, Exhibit 2 contains the percentage of access charges that are billed in advance over the last five years. In addition, Exhibit 2 sets forth BellSouth's claims in bankruptcy proceedings since January, 2000. All of these proceedings remain open, so BellSouth cannot calculate the percentage recovered.

expectation that such changes would receive regulatory acceptance. To the extent, however, the Commission has viewed the deposit provisions with caution because of concerns that competitors have limited access to capital markets, the alternatives could be far more draconian in effect.

23. BellSouth's deposit revisions do not require the customer to provide the deposit in cash. Instead, the customer can meet deposit obligations through cash substitutes such as security interest in tangible assets or a surety bond. Accelerated billing cycles and advance payments increase the need for customers to have access to cash. To the extent they are experiencing cash flow problems, such mechanisms will force these customers to seek access to capital markets more and more frequently but probably with far less success. If these access customers cannot obtain the cash to meet the more rapid billing cycles and advance payments, they will have to take steps to improve cash flow which would mean billing their end user customers in advance and more frequently for their telecommunications services.

24. The least disruptive mechanism to address the changed market circumstances is to change the existing rate-of-return based deposit mechanism to a more meaningful credit mechanism that is reflective of current market conditions. BellSouth's proposed tariff revisions accomplish this objective.

25. The Designation Order questions the adequacy of BellSouth's description of determining the creditworthiness of an access customer.[12] As the proposed tariff indicates, BellSouth will use commercially acceptable credit scoring tools to determine whether deposits

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[12] Designation Order ¶ 15.

will be required from a customer. BellSouth is not creating a new approach to measuring creditworthiness. To the contrary, BellSouth's tariff would apply standard credit measurement tools that are used throughout American industry, including the telecommunications industry. Indeed, BellSouth's credit manager performed the same function using the same credit tools for an interexchange carrier before joining BellSouth.

26. BellSouth's tariff would put into place the same type of standard credit review process that is used by professionals in non-regulated settings. Credit review is a necessary step where, as in the case of BellSouth, a service is provided and there is a risk of nonpayment. The need is especially acute in the telecommunications industry. KMV, a firm that specializes in measuring the probability of default of publicly traded companies, identified the telephone industry as having experienced the largest deterioration in credit risk.[13]

27. Credit Today, a periodical for credit specialists, describes the credit review analysis as:

> The credit analysis process is intended to investigate the prospective customer's financial condition to determine the customer's ability to pay you according to the agreed upon terms of sale and to access the risk associated with selling to that potential customer.[14]

28. To assess credit risk, BellSouth uses two different models. The first model is RiskCalc software developed by Moody's Risk Management Services. The RiskCalc software

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[13] KMV measured the rate of increase of companies' expected default frequency. Credit Today, *U.S. Credit Risk Is Rising Sharply and Approaching a Modern All-time High*, Jan. 2001 at 1, 12.

[14] *Great Checklists for Setting Up New Accounts-Advice From a Pro: Part One,* Credit Today, Nov. 2001 at 1, 12.

has been designed to act as an early warning system to monitor changes in the financial stability of corporations. This model is used to assess the credit risk of all companies. Exhibit 3 provides a brief description of the RiskCalc methodology.[15] The RiskCalc model, provides a risk rating between 1 and 10 with a score of 1 being the least risky and 10 the most risky.

29. The second is Dun & Bradstreets (D&B's) Risk Assessment Manager ("RAM") software.[16] The software is based on D&B's modeling expertise and is used by over 3,000 companies. While the RAM software also uses financial inputs, it allows the user to introduce data it has regarding a particular customer. For the purposes of its credit analysis, BellSouth uses this feature to introduce a customer's payment history. Thus, while payment history alone should not be determinative of whether a deposit is necessary, BellSouth does take it into account in determining the creditworthiness of a customer. Like Moody's RiskCalc, RAM provides a credit risk score between 1 and 10; however, a score of 1 represents a high credit risk and a score of 10 represents a low credit risk.

30. These models take into account the factors that BellSouth identified in its tariff in assessing the credit risk of individual customers. The business success of D&B and Moody's depends on the reliability of these models to be reasonable predictors of credit risk. Were they not good predictors of credit risk, not only would BellSouth not purchase the models, but, in addition, numerous other users of these models would abandon them as well.

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15 Exhibit 4 provides more comprehensive documentation of the RiskCalc model.

16 Exhibit 5 provides the documentation for the RAM software.

31. BellSouth's experience has been that customers who score at least five in both models are sufficiently creditworthy so as not to require a deposit.[17] Of course, the models are based on historical data. In order to take into account current information, customers can provide BellSouth with information that would offset a poor RAM or RiskCalc score. Likewise, BellSouth's credit specialists take into account current information that might negate good scores. For example, based on historical data, a customer's scores might indicate a low credit risk; however, the customer's might announce an accounting irregularity that when corrected will result in a restatement of revenues and earnings such that the customer's financial reports will be reporting losses for the last two years. Such current information would override the model scores and be taken into account by BellSouth's credit specialists in determining the need for a deposit.

32. The level of financial transactions between BellSouth and its access customers each month mandates a professional approach to credit analysis. BellSouth's proposed deposit provision would put into place a commercially sound means for assessing a customer's credit risk.[18] While as a common carrier BellSouth is required to provide service upon reasonable

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17 The Designation Order requested the scores for BellSouth and for BellSouth's long distance affiliate. For BellSouth Corporation, the RAM score is 5.3 and for BellSouth Long Distance, Inc., the RAM score is 5.9.

18 The Designation Order requests the payment characteristics of defaulting interstate access customers during the year prior to the time the account was 90 days overdue. Designation Order ¶ 16. BellSouth did not track customer data in this manner. BellSouth's recent experience is that there is little time between a customer defaulting on its bills and seeking bankruptcy protection.

demand, it is unreasonable to place the risk of a customer's poor business plans and ultimate failure upon BellSouth and its shareholders.

B. Refund of Deposits

33. The Designation Order questions why BellSouth did not include provisions that require it to periodically review the need for a security deposit and why BellSouth should not make refunds after timely payments had been received for twelve months. It is appropriate to answer the second request first. For all of the reasons set forth in this Direct Case, it is no longer appropriate for BellSouth to extend credit solely on the basis of payment history. Payment history with BellSouth as the sole determiner of whether security ought to be refunded to the customer is the product of a bygone era where the environment was dominated by rate of return and monopoly provision of local exchange services.

34. While BellSouth does review the credit of its interconnection business unit customers throughout the year, it cannot, due to resource constraints, obligate itself to reviewing every customers' credit on an annual basis. Further, as all behavior that dictates a customer's creditworthiness is in the hands of the customer, the customer is the best resource as to determine when creditworthiness has improved. It should be the customer's obligation to inform the supplier of a positive change in its creditworthiness status. BellSouth is ready, willing and able to respond to a customer's request to review its credit standing.[19] The review will be swift, nondiscriminatory and in accordance with the same factors utilized to establish creditworthiness

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[19] BellSouth does review the credit of its interconnection business unit customers on a rolling annual basis but it cannot, due to resource constraints, commit to reviewing every customers' credit on an annual basis.

initially.[20] As creditworthiness, which includes as a factor the customer's payment history, is the correct model to determine whether credit should be extended to a customer, it is appropriate to utilize the same professional, nondiscriminatory approach to determine whether BellSouth should continue to require security for the extension of credit or whether the currently held security can be returned.

35. The Designation Order seems to indicate that there may be some confusion as to the standards that apply to new customers. When new customers apply for service, the proposed tariff states that:

> BellSouth may require a new Customer to complete an application for service provided by the Company [and] [b]ased on its review of the Customer's creditworthiness or if the Customer has a proven history of late payments on undisputed charges to the Telephone Company or if the Customer does not have established credit, BellSouth reserves the right to secure the account with a security deposit.

It is clear that BellSouth is proposing to examine the creditworthiness of a new customer based upon the same criteria utilized for existing customers, and that the refund of the deposit held by BellSouth will be based upon the application of the same standards utilized to determine if security is required.

C. Dispute Resolution

36. The Designation Order questions whether the requirement that dispute resolution be conducted on an expedited basis through a third party arbitration process is just and reasonable.

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20 BellSouth did agree, in the context of the negotiations with the petitioners that, upon the effective date of the proposed tariff, to change its current policy of applying interest at the refund of the deposit or the disconnection of the account to crediting the account with the 12 percent interest earned on an annual basis.

BellSouth's original tariff proposal filed on July 19, 2002 did not address how a dispute as to the appropriateness of a deposit demand from BellSouth would be handled. BellSouth had determined there was no need for language regarding the resolution of such disputes, as mechanisms were already in place within the Communications Act and the FCC's rules and regulations. However, the Commission Staff encouraged BellSouth to meet with petitioners, to discuss the issues raised in the petitioners' filings and to negotiate compromises with petitioners wherever possible. One of the issues raised by the petitioners was the issue of dispute resolution. The petitioners did not feel that the current remedies available to them were sufficient to address a deposit dispute. As a compromise, BellSouth agreed to third party arbitration[21] to resolve disputes regarding the appropriateness and the amount of the deposit demand. BellSouth further agreed to maintain the status quo (i.e., not to discontinue service to the customer for failure to pay the deposit requested) during the pendency of the arbitration proceeding. In order to further the goal of the tariff revision, to adequately secure BellSouth's extension of credit to a customer whose creditworthiness has decreased to a "commercially significant" extent, BellSouth proposed that the arbitration proceeding be performed in an expedited manner. The Designation Order is correct when it states BellSouth's reasoning behind the expedited procedure: "With respect to the expedited arbitration procedures, BellSouth is clearly interested in receiving a security deposit promptly once it determines that a deposit is warranted under the proposed

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21 BellSouth's FCC tariffs include other references to the use of alternative dispute resolution. *See* BellSouth's FCC tariff No. 1, section 2.3.10 regarding contested Percent Interstate Usage audits.

creditworthiness standards and precluding a customer from delaying providing a deposit through an extended arbitration proceeding."[22] Both the alternative dispute resolution mechanism and the expedited process were agreeable to the petitioners. As the expedited alternative dispute resolution mechanism was a product of compromise negotiation between BellSouth and the petitioners and furthers BellSouth's and the customer's goal of resolving disputes in a timely manner, the proposed language is just and reasonable.

37. The American Arbitration Association ("AAA") rules and procedures for commercial dispute resolution authorize the expedited procedure, where parties agree to such use. The expedited process allows notice of the initiation of an arbitration by telephone; requires that an arbitrator be selected within 7 days of the submission of the list of potential arbitrators to the parties by the AAA; requires that a hearing be set within 30 days of the confirmation of the arbitrator's appointment; states that generally the hearing shall not exceed one day;[23] and requires that the award shall be rendered not later than 14 days from the date of the closing of the hearing.[24] An arbitration that is not expedited allows either party to submit a claim to AAA in writing; requires that the arbitrator(s) be appointed within 15 days of the submission of the list of potential arbitrators to the parties by the AAA; establishes no time frame for the setting of the

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22 Designation Order ¶ 24.

23 A one-day hearing is sufficient for the issues to be considered under the proposed arbitration. The arbitrator would be deciding a maximum of two points: (1) was BellSouth's deposit request justified (had the customer's creditworthiness diminished in a commercially significant way); and (2) whether the amount of the deposit requested was appropriate. These points could be presented by a maximum of two witnesses.

24 *See* American Arbitration Association, Commercial Dispute Resolution Procedures, as Amended and Effective on July 1, 2002, Rules E-1 through E-10, *available at* www.adr.org/index2.1.jsp?JSPssid=15747.

hearing; and requires that the award be rendered not later than 30 days from the date of closing the hearing. [25]

38. As the expedited process is a quicker procedure, involves only one arbitrator; deals with definitive issues; and is confined, generally, to one day, the expenses are less than if the expedited process is not used. Thus the costs of the proposed arbitration process are well defined and should, in no way, effect a customer's ability to bring a dispute should the customer feel that BellSouth is treating it unfairly.[26]

39. In paragraph 25, the Designation Order claims that "[t]he requirement that the losing party pay all the arbitration costs could significantly alter the balance between BellSouth and the customer." Nothing could be further from the truth. To the contrary, the requirement maintains the balance between the customer and BellSouth, especially given the reduced expense that might be incurred due to the expedited procedure. The balance is maintained due to the fact that both BellSouth and the customer must consider shouldering the entire expense incurred when the facts do not support the demand for the deposit or when there are no grounds to oppose the deposit demand. There is no imbalance based upon the size of the party because BellSouth, if discriminatory in its implementation of the proposed tariff, faces potentially hundreds of arbitrations with the potential of paying the entire arbitration costs for all of the those arbitrations while the customer has only itself to concern. The requirement that the losing party pay all of

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25 *See id.*, Rules R-1 through R-56.

26 The costs of the expedited alternative dispute resolution procedure would certainly be less than the process presently available to a customer of BellSouth that might wish to pursue a claim of discriminatory treatment based upon a request for a deposit.

the arbitration costs is, in effect, a "check and balance" mechanism, especially for BellSouth where the potential for multiple customer proceedings is very real if the tariff is not implemented in a nondiscriminatory manner. BellSouth has absolutely no incentive to implement the proposed tariff in a discriminatory manner given that the status quo is maintained during the pendency of the proceeding; that the loser incurs the costs of the arbitration; and that, after the proceeding had concluded, BellSouth would not have secured the account. On the other hand, the customer has the incentive to bring only legitimate claims of discriminatory treatment under the deposit provisions, as to do otherwise would cause it to incur the total cost of the arbitration proceeding as well as to remit the requested deposit to BellSouth.

40. The rules of the AAA do not conflict with the concept of the loser paying the costs of the arbitration. Rule 45(c) states that:

> In the final award, the arbitrator shall assess the fees, expenses, and compensation provided in Sections R-51, R-52, and R-53. The arbitrator may apportion such fees, expenses, and compensation among the parties in such amounts as the arbitrator determines is appropriate.

Further, while Rule R-52 states that the general rule is that the expenses of the arbitrator, any expense initiated by the arbitrator and the AAA representatives shall be borne equally by the parties, the parties may otherwise agree to the distribution of expenses in another manner. In the instant case, the "stick" of the payment of all costs associated with the arbitration is appropriate to ensure the balance of the speedy resolution of legitimate deposit requests.

D. Application of Revised Deposit Requirements to Term Plan Customers

41. The Designation Order questions whether the revised deposit provisions constitute a material change to long term plans that are offered in its access tariff. There are two types of

plans provided by BellSouth. The first type of plan is the long term pricing plan that is available to all subscribers in all MSAs in which BellSouth provides service. These various pricing plans of this type are enumerated in Section 2 of BellSouth's Tariff F.C.C. No. 1. The second type of long term arrangement is the contract tariff that BellSouth has been able to offer in MSAs in which it has received pricing flexibility.

42. With respect to the long-term pricing plans, neither the deposit provision nor any other general regulation are part of the long-term pricing plans that BellSouth has in effect in its interstate access tariff. As a general matter, all that the payment plans provide are service rates that are lower than the month-to-month rates, with a commitment on the part of BellSouth not to increase the service rates in exchange for a term commitment from the customer.

43. Specifically, BellSouth's Area Commitment Plan (ACP) provides reduced recurring rates for switched and special access transport services in exchange for a specific volume and term commitment from the customer. The regulations of the Area Commitment Plan explicitly state that the ACP rates are specified in the rate regulations of the individual services.[27]

44. For BellSouth's Fast Packet Services Plan, the tariff provides that the plan applies to Fast Packet Services in Sections 21 and 23 of BellSouth's tariff. When a customer subscribes to the payment plan, the customer elects a term period, and the payment plan rates that are set forth

[27] BellSouth Telecommunications Tariff FCC No. 1, Section 2.4.8(B), Original Page 2-49.0.1.1 (effective Jan. 13, 2001).

in Sections 21 and 23 of the BellSouth's tariff are stabilized, *i.e.*, "exempt from Telephone Company initiated increases."[28]

45. The Transport Payment plan operates in a similar fashion.[29] The rate regulations of the plan refer to specific services that are eligible and provide that the "stabilized monthly recurring rates as set forth in Sections 6 and 7"[30] are "exempt from Telephone Company initiated increases."[31] As in the other rate plans, nowhere does BellSouth commit to freeze its tariff provisions in exchange for a customer's term commitment. The only commitment made by BellSouth in all of these payment plans is to stabilize recurring rates. As demonstrated above, it is abundantly clear that none of BellSouth's long-term payment plans limit BellSouth's ability to modify the general regulations of its access tariff.

46. To the extent that the Contract Tariff arrangements incorporate the general regulations of BellSouth's access tariff, including deposit provisions, the Commission evaluates changes to long-term contract tariffs under the "just and reasonable" standard codified in Section 201(b) of the Act. In determining whether modifications satisfy this reasonableness test, the Commission employs a two-part analysis. The Commission first evaluates whether the modification is a material change. If the change is not material, the tariff as modified is deemed

28 BellSouth Telecommunications, Inc. Tariff FCC No. 1, Section 2.4.8(C)(1)(f), 3rd Revised Page 2-49.0.3 (effective Mar. 3, 2001).

29 The Transport Payment Plan replaced the Channel Services Payment Plan in 1999.

30 BellSouth Telecommunications, Inc. Tariff FCC No. 1, Section 2.4.8(D)(2)(a), 3rd Revised Page 2-49.0.10 (effective June 12, 1999).

31 BellSouth Telecommunications, Inc. Tariff FCC No. 1, Section 2.4.8(D)(1)(h), 3rd Revised Page 2-49.0.10 (effective June 12, 1999).

reasonable and is approved without further examination. If, however, the change is deemed to be material, the Commission continues its analysis and evaluates whether the carrier has "substantial cause" to make such a modification. If the carrier demonstrates substantial cause, the tariff change is reasonable under Section 201 and the tariff revision is approved.

47. In this case, an examination of relevant precedent from the Commission, courts, and commercial and common law contracts unequivocally demonstrates that BellSouth's revision does not constitute a material change. Consequently, the Commission's analysis is concluded and the tariff should be approved as reasonable. Even assuming *arguendo* that the revision is a material change, however, there is no question that BellSouth has substantial cause to extend the security deposit requirements to existing customers.

48. There is no Commission precedent expressly addressing whether a revision that ensures that existing customers satisfy basic norms of creditworthiness is a material change. The Commission's precedent does, however, shed light on the type of modifications that are considered to be material: those that have a direct impact on performance or the overall structure

of the contract, such as price,[32] volume discounts,[33] duration of the contract,[34] imposing financial caps on key provisions of the contract,[35] altering termination liability,[36] and elimination of the availability of certain key provisions.[37] These material changes all impact the customer's fundamental legal obligations and rights under the contract. In this case, there is no such impact. To the contrary, none of the relevant performance issues or prices are affected. Not even ancillary issues, such as the time and method of payment, are impacted. Rather, BellSouth is merely extending existing credit terms to cover all classes of customers. Under the Commission's precedent, this is not a material modification.

49. Moreover, while the Commission has not addressed the materiality of credit terms, an examination of basic contract and commercial transactions law, which the Commission has

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[32] *RCA American Communications Inc., Revisions to Tariff F.C.C. Nos. 1 and* 2, CC Docket No. 80-766, Transmittal Nos. 191 and 273, *Memorandum Opinion and Order,* 86 FCC 2d 1197, ¶ 1 (1981) (proposing to "substantially" increase rates in its tariff) ("*1981 RCA Order*").

[33] *See e.g., AT&T Communications Contract Tariff No. 374*, Transmittal Nos. 2952 and 3441, *Order,* 10 FCC Rcd 7950, ¶ 1 (1995) (proposing to modify contract price and volume discounts).

[34] *See, e.g., 1981 RCA Order*, 86 FCC2d at 1203, ¶¶ 16-18 (proposing, among other things, to shorten the service terms of the tariff).

[35] *See, e.g., AT&T Communications Contract Tariff No. 360*, Transmittal No. CT 3076, *Order,* 11 FCC Rcd 3194, 3195, ¶¶ 1, 3 (1995) (proposing a monthly cap of $205,000 for the free calling provided for in the tariff).

[36] *See AT&T Communications Revisions to Tariff F.C.C. No. 2*, Transmittal Nos. 2404 and 2535, *Order,* 5 FCC Rcd 6777, ¶ 1 (1990) (proposing to change tariff provisions pertaining to termination of its service term plans).

[37] *See AT&T Communications Revisions to Tariff F.C.C. No.* 1, Transmittal No. 8640, *Order,* 10 FCC Rcd 12287, ¶ 1 (1995) (proposing to discontinue the availability of certain provisions of its tariff).

found is "highly relevant" in evaluating substantial cause,[38] demonstrates that BellSouth's modification does not constitute a "material" change.[39] Section 2-207 of the UCC details the proper treatment of adding terms to a contract and gives guidance as to what does and does not constitute a "material" term. The Official UCC Comments to § 2-207 explain that a modification is "material" if it would result in "surprise or hardship."[40] The Official Comments also provide examples of non-material contract revisions that "involve no element of unreasonable surprise" and expressly include revisions involving the terms governing creditworthiness and a buyer's failure to pay for goods. In particular, Comment 5 specifies that a revision is not material if it is "a clause providing for interest on overdue invoices or fixing the seller's standard credit terms."[41] In the instant situation, BellSouth is making a minor revision to "fix a seller's standard credit terms" to ensure that it receives payment for services rendered. Under the UCC, there is no question that BellSouth's revisions are not "material" changes. Indeed, courts in various jurisdictions that have evaluated analogous issues confirm that revisions to credit terms and finance charges do not constitute "material" changes to a contract.[42]

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[38] *See Tariff Filing Requirements For Nondominant Common Carriers*, CC Docket No. 93-36, *Order*, 10 FCC Rcd 13653, 13656, ¶14 (1995) ("commercial contract law principles are highly relevant to an assessment of whether a contract-based tariff revision is just and reasonable under the substantial cause test") (*citing Competition in the Interstate Interexchange Marketplace*, 10 FCC Rcd 4562, 4574, ¶ 25 (1995)).

[39] Although the Uniform Commercial Code ("UCC") applies to the sales of goods, not services, the reasoning and analysis in the Official Comments is equally valid here.

[40] UCC § 2-207 (1998), Official Comment 4.

[41] UCC § 2-207 (1998), Official Comment 5.

[42] *See, e.g., Tri-Circle Inc., v. Brugger*, 829 P.2d 540 (Idaho Ct. App. 1992); *Rangen, Inc. v. Valley Trout Farms*, 658 P.2d 955 (Idaho 1983); *Tim Henningan Co. v. Anthony A. Nunes, Inc.*, 437 A.2d 1355 (R.I. 1981).

50. Moreover, common law contract principles provide further confirmation that BellSouth's revision to its tariff is not a "material" change. For example, the Restatement (Second) of Contracts explains that "an alteration is not material, however, unless it purports to change the legal relationships under the contract."[43] In this case, extending to existing customers the credit and deposit terms that already apply to new customers does not alter the legal relationship in any respect. All the "material" terms of the contract, such as price, terms, penalties, guarantees, duration, liability, and time of payment, remain the same.

51. In sum, while the Commission has not squarely ruled on whether the instant situation involves a "material" change, an examination of related FCC precedent and relevant contract law – including both UCC and common law – unequivocally demonstrates that BellSouth's tariff revision is not material. Because the Commission has long held that the substantial cause test is not triggered unless there is a material revision to a tariff, the Commission need not conduct any further inquiry before approving BellSouth's revision.[44]

52. Even if the tariff modification were material, BellSouth has substantial cause to make the modification. The Commission measures the reasonableness standard under Section 201(b)

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[43] Restatement (Second) of Contracts § 286, Comment b (1981).

[44] *See e.g., Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, *Memorandum Opinion and Order*, 10 FCC Rcd 4562, 4573, ¶ 23 (1995) ("the 'substantial cause' test applies to tariff revisions that alter material terms and conditions of a long-term contract."); *see also RCA American Communications Inc. Revisions to Tariff FCC Nos. 1 and 2*, CC Docket No. 80-766, Transmittal No. 191, *Memorandum Opinion and Order*, 84 FCC 2d 353, 358-59, ¶ 17(1980); *Memorandum Opinion and Order*, 86 FCC 2d 1197, 1201-02, ¶¶ 12-13 (1981) *("1981 RCA Order"), remanded, RCA American Communications, Inc. v. FCC, 684 F.2d 1033* (D. C. Cir. 1982), *on remand, Memorandum Opinion and Order*, 94 FCC 2d 1338 (1983); *RCA American Communications Inc. Revisions to Tariff FCC Nos. 1 and 2,* Transmittal No. 273, *Memorandum Opinion and Order*, 2 FCC Rcd 2363 (1987) ("*1987 RCA Order*"), *pet. for rev. denied sub nom. Showtime Networks, Inc. v. FCC*, 932 F.2d 1 (D.C. Cir. 1991).

of material revisions to a tariff by applying a "substantial cause" test. In applying this test, the Commission balances: (1) the carrier's explanation of the factors necessitating the tariff change, and (2) the position of the customer.[45] The Commission determines "on a case-by-case basis in light of all relevant circumstances, whether a substantial cause showing has been made."[46] As detailed below, even though the Commission need not conduct a substantial cause evaluation in this case because there has been no material change to BellSouth's tariff, BellSouth easily satisfies the substantial cause test.

53. The first prong of the test examines the carrier's reason for the change. While the application of the substantial cause test is fact-specific, the Commission has highlighted certain factors that are relevant, but not necessary, for substantial cause. Thus, events that were "clearly unforeseeable" when a tariff was issued provided substantial cause for a subsequent tariff revision.[47] The Commission also looks to see if a carrier will be harmed if the revision is not approved. In *Hi-Tech Furnace Systems v. Sprint Co.*, for example, Sprint modified a fundamental term of its "Fridays Free" international calls plan by eliminating 9 countries from

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45 *See 1981 RCA Order*, 86 FCC.2d at 1201; *Hi-Tech Furnace Systems, Inc. and Robert E. Kornfeld v. Sprint Communications Company, L.P.*, File No. E-98-36, *Memorandum Opinion and Order*, 14 FCC Rcd 8040, 8045, ¶ 12 (1999) ("*Hi-Tech Order*") *aff'd, Hi-Tech Furnace Systems, Inc. v. FCC*, 224 F.3d 781, 791 (D.C. Cir. 2000).

46 *See Hi-Tech Order*, 14 FCC Rcd at 8045, ¶ 12 (*citing Competition in the Interstate Interexchange Marketplace, Memorandum Opinion and Order on Reconsideration*, 10 FCC Rcd 4562, 4574 (1995) (*Reconsideration Order*)).

47 *See Hi-Tech Order*, 14 FCC Rcd at 8047, n. 47 (quoting *1987 RCA Order* at 2366-67). In RCA, the Commission found substantial cause for a carrier to increase rates because the carrier incurred increased costs – due to increased insurance rates, higher inflation, the loss of one of the carrier's satellites, and because investors viewed the satellite business as riskier at the time of the revision – which were unforeseeable at the time the carrier filed its long-term tariff. *See id.* at 8045-46, ¶ 13.

the plan after incurring increased international call volume that taxed Sprint's network. The Commission found that Sprint had substantial cause to modify its tariff because the increased call volumes harmed Sprint by threatening its ability to complete calls on its network.[48] In addition to harms to a network, the Commission has also found substantial cause when carriers have suffered economic and financial harm.[49]

54. Turning to the instant modification, unforeseeable factors plainly compelled BellSouth to make this change, and BellSouth will suffer harm if the change is not approved. BellSouth's minor modification is necessitated by events unforeseen at the time some of the contracts were entered into. Some of BellSouth's existing carrier customers are facing financial difficulties, some are unable to pay their liabilities and debts and are on the verge of bankruptcy, and many no longer have the credit rating they did when BellSouth's entered into the long-term contract. This dramatic change was unforeseeable at the time the contracts were entered into, and, indeed, was unthinkable until it occurred. In light of the current circumstances, BellSouth needs added protection to ensure that it receives compensation for service rendered pursuant to these long-term contracts. Otherwise, BellSouth faces the concrete risk that it will suffer significant financial harm.

55. The second prong of the substantial cause test looks at the impact of the modification on the customer. In applying this prong, the Commission weighs the impact on the customer with the consequences of denying the modification on the carrier. Thus, in evaluating the impact

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48 *Id.* at 8046, ¶ 14.

49 *See, e.g., 1987 RCA Order*, 2 FCC Rcd at 2367, 2368, ¶¶ 30, 32.

on the customer, the Commission has examined whether the customer has any justifiable reliance on the existing provisions, whether the customer had any advance notice of the change, and finally, the Commission looks at what steps the carrier has taken to ameliorate the impact on the customer.

56. For example, in the Sprint "Fridays Free" case, the Commission found that the customer did not prove justifiable reliance on the 9 countries that were deleted from the Fridays Free program because: (1) the customer did not call the deleted countries heavily, and (2) the customer switched to Sprint not only because of the Fridays Free program, but also because the rates were attractive.[50] In addition, the Commission found that the customer had advance notice that terms could change because the Fridays Free tariff explained that the plan was governed by Sprint's general tariff, which expressly could be amended.[51] The Commission therefore concluded that the customer had no justifiable reliance and the substantial cause test was satisfied.

57. The Commission also balances the impact on the customer with the harm that the carrier would suffer absent the modification. In conducting this balancing test, the Commission examines steps that the carrier has taken to mitigate the impact of the tariff revision. As a result, the Commission has found substantial cause where the "impact on the customers was not

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[50] *Hi-Tech Order*, 14 FCC Rcd at 8049, ¶ 22.

[51] *Id.* at 8050, ¶ 23.

unreasonably burdensome" because the carrier had eliminated early termination liability, which, the Commission found, "substantially mitigate[d]" the impact of the rate increases.[52]

58. Applying the second prong to BellSouth's modification, there will be little, if any, impact on customers. For customers with satisfactory credit, there is no change. It is only for customers whose credit does not satisfy reasonable standards of creditworthiness that the clause is even triggered. In these cases, customers must provide a security deposit to ensure that, in the event they do not pay for services rendered, BellSouth can apply the deposit funds towards the unpaid services. At no other time will the funds be used, and BellSouth agrees to apply interest to the funds. In light of the Commission's precedent, it is clear that BellSouth's revision has little or no impact on its customers.

59. Nor do customers of the contract tariffs have a justifiable reliance that the deposit terms would not change. To the contrary, those pricing plans incorporate the payment terms in BellSouth's general access tariff, which are plainly subject to modification. The affected customers therefore had advance notice that the deposit provisions might be altered.

60. In light of the foregoing, BellSouth's modification clearly satisfies the requirement that the revision be reasonable, under all of the Commission's standards. Accordingly, BellSouth's long-term plans do not present any obstacle to the effectiveness of the proposed deposit regulations.

52 *See 1987 RCA Order*, 2 FCC Rcd at 2368, ¶ 32.

E. Requirement For Service Application for New Customers

61. The application for service referenced in the deposit provision is a credit application. Exhibit 6 provides a copy of the application. As can be seen, the application is a one-page form to be completed by the customer. It requests credit and banking references and authorizes such references to release information to BellSouth. The purpose of the application is to obtain information that relates to the creditworthiness of the customer. The application is not burdensome nor is it requesting information that BellSouth obtains elsewhere. The information is not used to deny service but is part of the overall information to determine whether a deposit would be required.

III. CONCLUSION

62. The time has come to cast aside the 1980's approach to customer deposits. The competitive environment mandates that BellSouth be able to assess its customers' ability to pay for the services they purchase as any other supplier of goods and services does for its customers. Neither BellSouth nor its shareholders should have to bear the risk of its competitors' poor business decisions and business failures. In this Direct Case, BellSouth demonstrates the reasonableness of the modifications it has proposed to the deposit provisions of its interstate

access tariff. Accordingly, the Commission should find these provisions lawful and permit them to take effect.

Respectfully submitted,

BELLSOUTH TELECOMMUNICATIONS, INC.

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Date: October 10, 2002

BELLSOUTH DIRECT CASE

WC DOCKET NO. 02-304

EXHIBIT 1

BELLSOUTH INTERSTATE ACCESS SERVICES
BILLED IN ADVANCE AND BILLED IN ARREARS

SERVICE DESCRIPTION	BILLED IN ADVANCE	BILLED IN ARREARS
Carrier Common Line BellSouth no longer bills Interstate Carrier Common Line charges	**PICC charges** billed to the end user customer	**PICC charges** (excluding those billed to the end user)
End User Access Services	End User Common Line charges Federal USF charges (excluding those billed to end user special access customers)	Federal USF surcharge billed to end user special access customers
Switched Access Services	Monthly recurring charges	Usage-based charges Installation charges Non-recurring charges
Special Access Services	Monthly recurring charges	Installation charges Non-recurring charges
Directory Assistance **Operator Services** **LIDB Access Service**	Monthly recurring charges	Usage-based charges Installation charges Non-recurring charges
Virtual Expanded Interconnection Services	Application Fee Monthly recurring charges Cable Installation charges	Non-recurring charges Security escort charges Engineering charges
Fast Access Packet Services	BellSouth ADSL Service Exchange Access ATM Service Managed Shared ATM Service Exchange Frame Relay Service Managed Shared Frame Relay Service	Remote Access Service

Designation Order Paragraph 12 Issues and Responses

Issue: BellSouth should describe its billing and collection procedures and explain any changes in the procedures or the accounting treatment of disputed amounts on bills within the past two years that could have affected the levels of uncollectibles.

Response: BellSouth uses a structured timeline to trigger collections in the billing cycle. All billing less than 30 days old is considered current, and is not collectible. Treatable billing is billing over 31 days old, excluding disputed dollars. The treatment timeline is slightly different depending on whether the billing is rendered through BellSouth's Customer Records Information System (CRIS) or Carrier Access Billing System (CABS).

If billing is rendered through CRIS, the billing system will generate a late notice to the customer on the 35^{th} day of the billing cycle for the treatable billing. If payment is not made before day 53 of the cycle, the customer's account team advocate and BellSouth's finance group are notified of the past due situation. On day 54, Provisioning will hold order processing. If payment is not received by day 56, the customer is notified of BellSouth's intent to disconnect service. On day 66, service to the customer's end users is denied. If payment is not received by day 82, BellSouth will disconnect the carrier's service.

The timeline for CABS billed services is different. The initial notice is sent to the customer on day 31. The initial notice is a Presubscribed Interexchange Carrier (PIC) freeze notice. If payment is not made by day 38, BellSouth will block the customer's ability to change PIC. On day 40, BellSouth will mail a notice to advise the customer that orders will be held in 30 days. On day 70, BellSouth will hold order processing. If payment is not received by day 75, BellSouth will disconnect the carrier's service.

BellSouth's billing and collection procedures, or the accounting treatment of disputed items, have not significantly changed within the past two years. Therefore, any change in the level of uncollectibles is not attributed to changes in BellSouth's procedures. The BellSouth collection process and timeline is attached to this document for review.

Issue: BellSouth shall indicate the average length of time from the bill date until the bill is sent to the carrier customer, and what percentage of those bills, by number of entities and by billed amount, is sent electronically.

Response: BellSouth strives to send bills to the customer by the 6th day after the bill date; BellSouth meets this commitment at least 99.2% of the time. All bills are sent by the 7th calendar day. That commitment is met 100% of the time. Approximately 36% of BellSouth's 663 wholesale customers receive their bill media in the electronic, BDT format. The dollar amount represented by the 36% is not available.

Issue: BellSouth shall provide the Commission with the number of customers that have been sent non-payment, discontinuance of service, or refusal of new orders letters in the past year and the average length of time from a bill's being delinquent until the letter was sent.

Response: In the past year BellSouth has sent 443 fax refusals and 294 certified disconnect letters to access customers. As the collection timeline shows, the fax refusal is sent to customers on day 31. If payment is not received, certified letters are sent on day 40.

In the same period, BellSouth has sent 47 disconnect letters to CLEC resale customers. In the CRIS collection time line, the first step of the collections process is a system-generated notice on day 35; BellSouth does not have the ability to track the number of notices generated in this manner. The disconnect letter, sent on day 56, has been sent to 47 customers.

Issue: To provide information on possible changes in customer behavior, BellSouth shall provide the Commission the percent of carrier bills disputed, the percent of carrier-billed revenues disputed, and the percentage of the disputed amounts that were successfully disputed by the carrier for billing periods beginning January 2000 to present.

Response: The table below depicts the information requested:

Month	% Bills Disputed	% Billed Revenue Disputed	% Disputed Adjusted
Jan-00	9	3	55
Feb-00	9	3	58
Mar-00	9	3	49
Apr-00	9	3	51
May-00	10	3	57
Jun-00	10	4	48
Jul-00	10	3	60
Aug-00	11	3	48
Sep-00	11	4	56
Oct-00	12	5	33
Nov-00	10	4	54
Dec-00	10	4	51
Jan-01	9	4	86
Feb-01	9	3	65
Mar-01	10	4	67
Apr-01	10	3	68
May-01	10	5	38
Jun-01	9	3	47
Jul-01	7	3	66
Aug-01	7	5	43
Sep-01	8	4	37
Oct-01	7	6	22
Nov-01	7	4	45
Dec-01	7	3	49

Jan-02	8	4	50
Feb-02	7	4	47
Mar-02	6	11	12
Apr-02	7	6	21
May-02	6	4	37
* Jun-02	4	3	32
* Jul-02	3	3	20
* Aug-02	2	2	6

* Note: Recent months include disputes that have not yet been resolved.

Issue: BellSouth should also indicate if it deducts disputed amounts from amounts billed for purposes of determining whether a carrier has complied with a deadline.

Response: BellSouth excludes disputed amounts from collectible revenue.

BELLSOUTH®
Network Services

Current Collections Process

Event / Timeline	CRIS	CABS
	30 day term	30 day term
1-30 - current Past due = 31+ Treatable dollars = Past due net disputes	Day 35 - System generated notice at account level is sent Day 53 - Pre notification e-mail to Account Team and Finance of potential hold Day 54 - Notify Provisioning to stop order processing Day 56 - Mail certified letter Day 66 - Deny end users Day 82 - Disconnect End users	Day 31 - Manual PIC Freeze notice to customer Note: If not PIC C proceed to certified letter Day 38 - Block PIC C Day 40 - Mail 30 day certified letter Day 70 - Hold new orders Day 75 - Disconnect

BELLSOUTH DIRECT CASE

WC DOCKET NO. 02-304

EXHIBIT 2

Designation Order Paragraph 13 Issue and Response

Issue: BellSouth shall indicate the percentage of interstate billings that are billed in advance, how this level has changed over the past five years, and how this change has affected the risk BellSouth faces.

Response: The chart below depicts the percentage of interstate billings that are billed from the Carrier Access Billing System in advance and the change in that percentage over the past five years. The data do not include charges such as subscriber line charges and PICCs billed to end users that are billed by a different billing system.

Year	Advance	Grand Total	Advance %
1998	$1,132,969,026.00	$2,370,592,336.00	48%
1999	$1,185,405,448.00	$2,409,860,798.00	49%
2000	$1,501,195,532.00	$2,401,850,533.00	63%
2001	$1,895,608,443.00	$2,371,771,489.00	80%
2002	$1,501,599,264.00	$1,695,474,911.00	89%
Total	**$7,216,777,713.00**	**$11,249,550,067.00**	**64%**

The data shown above represents interstate revenue billed through the Carrier Access Billing System (CABS). These revenues have declined over the past two years, with that trend continuing in 2002. Thus, the percentage of revenues that are billed in advance has dramatically increased.

Bankruptcies Filed in 2000

Customer	Case #	Date Filed	Issue	Claim Amount
GST	00-01983	5/17/00	Bankruptcy	
SunTel	00-5588	7/21/00	Bankruptcy	$276,430
American Metrocom	00-03358	8/1/00	Bankruptcy	$68,864
USC	00-37353	8/9/00	Bankruptcy	$7,556
Columbia Telecom	00-15033	8/16/00	Bankruptcy	$270,907
Jilapuhn aka TelAmerica	00-70843	8/16/00	Bankruptcy	
Communications Options	00-57772	8/29/00	Bankruptcy	$240
Net-Tel	00-1771	9/1/00	Bankruptcy	$1,067,395
Access Point	00-02630	11/1/00	Bankruptcy	$76,731
Access Point	00-02630	11/1/00	Bankruptcy	$14,453
ICG	00-4238	11/1/00	Bankruptcy	$69,879
Access Point	00-02630	11/1/00	Bankruptcy	$296,750
ICG	00-4238	11/1/00	Bankruptcy	$529,712
Jato	01-13546	12/1/00	Bankruptcy	$873,811
Pacific Gateway	00-33019	12/20/00	Bankruptcy	$3,982
Total				$3,556,710

Bankruptcies Filed in 2001

Customer	Case #	Date Filed	Issue	Claim Amount
Federal Transtel, Inc.	01-75399	12/11/01	Bankruptcy	$55,315
FEDERAL TRANSTEL	01-75399	12/11/01	Bankruptcy	$55,348
BROADRIVER	01-71888	9/19/01	Bankruptcy	$367,203
BROADRIVER	01-71888	9/19/01	Bankruptcy	$60,508
STARTEC	01-25013	12/14/01	Bankruptcy	$17,283
Prism	01-24830	7/16/01	Bankruptcy	$1,165,898
2ND CENTURY	01-16915	6/25/01	Bankruptcy	$3,491
ENRON	01-16034	12/2/01	Bankruptcy	$462
World Exchange	01-14637	4/24/01	Bankruptcy	$183,309
World Exchange	01-14637	4/24/01	Bankruptcy	$7
World Exchange	01-14637	4/24/01	Bankruptcy	$46,013
World Exchange	01-14637	4/24/01	Bankruptcy	$332
RHYTHMS ACI	01-14283	8/1/01	Bankruptcy	$1,032,825
RHYTHMS	01-14283	8/1/01	Bankruptcy	$438,370
Easton (Teligent)	01-12980	5/21/01	Bankruptcy	$19,219
American Long Lines (Teligent)	01-12976	5/21/01	Bankruptcy	$1,817
PT-1	01-12655	3/9/01	Bankruptcy	$949,741
Pathnet aka Prefered Network aka PNI	01-12264	4/2/01	Bankruptcy	$1,064,271
North American Telecom	01-10910	2/23/01	Bankruptcy	$1,299,282
NO. AM. TELECOM	01-10910	2/23/01	Bankruptcy	$10,259
Vectris Telecom	01-10157	1/25/01	Bankruptcy	$249,584
VECTRIS	01-10157	1/25/01	Bankruptcy	$116,049
VECTRIS	01-10157	1/25/01	Bankruptcy	$528,249
WINSTAR	01-01431	4/18/01	Bankruptcy	$14,414
WINSTAR	01-01431	4/18/01	Bankruptcy	$1,341,012
WINSTAR	01-01431	4/18/01	Bankruptcy	$52,377
WINSTAR	01-01431	4/18/01	Bankruptcy	$153,422
StarTel	01-00830	3/13/01	Bankruptcy	$25,000
NorthPoint	01-30125	1/16/01	Bankruptcy	$3,513,916
2rd Century	01-16916	6/25/01	Bankruptcy	$312,780
Rhythms (ACI)	01-14283	8/1/01	Bankruptcy	
Teligent Communication	01-12974	5/21/01	Bankruptcy	$61,531
Actel Integrated	01-12901	4/11/01	Bankruptcy	$1,317,985
Net 2000	01-11326	11/16/01	Bankruptcy	-$33,403
I Connect (ConnectSouth)	01-10851	3/11/01	Bankruptcy	$9,070,451
Broadband Office Inc	01-01720	5/9/01	Bankruptcy	$246,612
Pointcom aka Telscape	01-01563	4/27/01	Bankruptcy	
Winstar	01-01430	4/18/01	Bankruptcy	$872,864
E-Spire	01-00974	3/22/01	Bankruptcy	$0
North American Tel (V8667 for PSP)	01-10910	2/23/01	Bankruptcy	$370,652
Total				$24,984,445

Bankruptcies Filed in 2002

Customer	Case #	Date Filed	Issue	ST	Type	Claim Amount
Revenue Communications, Inc.	02-10319	1/15/02	Bankruptcy	TX	11	$2,412
Global Crossing	02-40188	1/27/02	Bankruptcy	NY	11	$20,979,642
Network Plus Corp.	02-10341	2/4/02	Bankruptcy	DE	11	$3,300,000
Logix Communications Corporation	02-32105	2/28/02	Bankruptcy	TX	11	$42,000
Nationwide Communications.	02-45374	3/5/02	Bankruptcy	MI	11	$2,191
Adelphia Business Solutions, Inc. (SC, FL, LA, 1/2 TN)	02-11388	3/27/02	Bankruptcy	NY	11	$2,641,858
Mpower Communications Corp.	02-11047	4/8/02	Bankrtuptcy	DE	11	$2,142,000
CRG International, Inc. d/b/a Network One	02-64401	4/22/02	Bankruptcy	GA	7	$8,275
Lightyear Communications, Inc	02-32725	4/29/02	Bankruptcy	KY	7	$382,662
DV2	02-94626	5/1/02	Bankruptcy			$22,994
Global Systems, Inc. (dba GSIWave.com)	02-03869	5/7/02	Bankruptcy	NC	11	$111,000
Teleglobe USA, Inc.	02-11409	5/15/02	Bankrtuptcy	DE	11	$92,000
Velocita Corp.	02-35895	5/30/02	Bankruptcy	NJ	11	$90,000
Network Access Solutions	02-11611	6/4/02	Bankruptcy	DE	11	$5,818,259
Birch Telecom, Inc.	02-12218	7/29/02	Bankruptcy	DE	11	$14,000
MCI/Worldcom						$117,000,000
Total						$152,649,293

BELLSOUTH DIRECT CASE

WC DOCKET NO. 02-304

EXHIBIT 3

Description

Moody's version of RiskCalc™ for public companies has been designed to act as an early warning system to monitor changes in the credit quality of corporate obligors. For each issuer, the model currently reports a one year *probability of default* (PD) using as inputs ratings (when available), market data and financial statement information. With the exception of financial institutions, whose capital structures tend to be quite unique, we are currently applying the model to all industries and U.S. firms.

Moody's model is a hybrid one that combines two credit risk modeling approaches: (a) a structural model based on Merton's options-theoretic view of firms, and (b) a statistical model determined through empirical analysis of historical data.

The statistical approach, which is the most frequently found in the literature, maps a reduced set of financial variables and other information to a risk scale. The mapping acts as a statistical distillation of the historical data and can be used to discriminate between good and bad credits. However, the analysis of historical financial statements may present an incomplete or distorted picture of the company's true financial condition. Unfortunately, while financial statements provide information directly about a firm's past, they are limiting in that they provide information only indirectly about its future.

The second modeling approach starts with a stylized mathematical representation of the firm's behavior. The valuation of corporate liabilities using the contingent claims framework introduced by Merton is an example of a structural model. The usefulness of such an approach depends on how closely its assumptions and structure capture the true nature of the firm dynamics as well as the accuracy with which the model's variables are estimated. In particular, the Merton model relies heavily on economic theories about market efficiency. The model contains embedded assumptions about the comprehensiveness of the information contained in market data when used within the structure of the model. However, knowledge of the market information *alone* does not directly inform an investor as to a borrower's creditworthiness.

Thus, while market information can be extremely valuable, we have found it to be most useful when also coupled with fundamental information on the firm and its business environment. A detailed examination of a firm's balance sheet, income statement and cash flows remains a critical component of any analytical risk assessment framework.

Moody's approach reflects this perspective. Our model incorporates variants of both a contingent claims model and a statistical reduced form model using a non-linear regression approach. The key inputs to this hybrid model are:

- Agency rating when available,
- Modified version of the Merton model (expressed as a risk-adjusted

market implied leverage),
- Company financial statement information,
- Additional equity market information; and
- Macroeconomic variables that represent snapshots of the state of the economy or of specific industries, which are used for preprocessing, model inputs.

Ratings and default information are obtained from Moody's proprietary rating and default databases for public firms. Fundamental financial and market information is collected from commercial vendors.

Additional benefits of RiskCalc™ include:

- Transparency,
- Moody's commitment to maintaining and improving the model,
- RiskCalc™ acceptance and understanding within Moody's structured finance group that rates pools of private loans for collateralized loan obligations, and
- Various complementary supporting information on the drivers of a final score.

Moody's Risk Management Services

A global organization providing technology, analytics, training and services for understanding and managing credit risk.

August 2, 2001

Description

RiskCalc™ for private companies is the next generation of Moody's RiskScore, and contains improvements in several dimensions: power, comprehensiveness, simplification of data requirements, and calibration to default probabilities.

The RiskCalc™ algorithm uses nine financial ratios and firm size, adjusts these inputs to linearize the modeling problem, and then estimates the final collection of transformed inputs within a probit model. The output is then mapped into a *Probability of Default* (PD) at 1-year and 5-year horizons. A final mapping to an estimated Moody's rating is based on the 5-year PD.

The model is estimated on U.S. and Canadian private firm defaults, and tested on private and public firm data. It is not intended for finance, insurance, and real estate industries. While not formally tested upon countries outside North America, limited testing on other regional exposures suggests the general applicability remains robust.

Two key facts underlie the usefulness of RiskCalc™ for private companies:

- It is specifically designed for private firms.
- It ties credit scores directly to default probabilities.

RiskCalc™ is the most statistically powerful model available for private firm default modeling primarily because it is estimated on private rather than public firms. Public and private firms are different in important ways. Private firms are typically smaller, with lower leverage, higher retained earnings, higher short-term debt, higher current ratios, and lower inventories than public firms with similar risk. While models fit to public companies can be useful when applied to private firms, the relationship between certain ratios and probability of default display markedly different behavior between public and private firms.

Having RiskCalc™ generate a PD, as opposed to a standard ordinal ranking, provides an important function of the model. This moves quantitative tools from merely monitoring trends to affecting pricing directly and enabling securitization. Further, the fact that the mean default rate for the entire middle market company segment, as determined by the model, is Ba2 as opposed to B2 implies that there exist substantial opportunities for balance-sheet collateralized loan obligations (CLOs) because post-CLO capital allocation could be well below that required when keeping entire portfolios of private firm loans on banks' books. By tying the output to a default rate, this model can also assist in the building of internal capital models within banks, in line with the new Basel capital directives.

Additional benefits of RiskCalc™ include:

- Transparency,
- Integration with underwriting and deal capture software

(e.g., FAMAS),
- Moody's commitment to maintaining and improving the model,
- RiskCalc™ acceptance and understanding within Moody's structured finance group that rates pools of private loans for collateralized loan obligations, and
- Various complementary supporting information on the drivers of a final score.

Like all new technologies, RiskCalc™ is a supplement to, not a substitute for, good judgement. Many factors not reflected in balance sheets and income statements are relevant to gauging loan risk. The score produced by RiskCalc™ alone cannot answer the deeper question as to whether the credit adds value from a portfolio and relationship perspective. However, what RiskCalc™ can do is efficiently summarize one portion of the problem (financial statements) so that an analyst can focus her expertise more productively.

Modeling Details

Many ratios are correlated with credit quality. In fact, *too many* ratios are correlated with credit quality. Given these variables' correlations with each other, one has to choose a select subset in order to generate a stable statistical model. Statistically, one is forced to choose among many potentially useful inputs. The final variables and ratios used in RiskCalc™ for private companies are the following:

RiskCalc™ for private companies Inputs and Ratios

Inputs (17)	**Ratios (10)**
Assets (2 yrs.)	Relative Assets
Cost of Goods Sold	Inventories / COGS
Current Assets	Liabilities / Assets
Current Liabilities	Net Income Growth
Inventory	Net Income / Assets
Liabilities	Quick Ratio
Net Income (2 yrs.)	Retained Earnings / Assets
Retained Earnings	Sales Growth
Sales (2 yrs.)	Cash / Assets
Cash & Equivalents	Interest Coverage
EBIT	
Interest Expense	
Extraordinary Items (2 yrs.)	

These ratios were suggested by their univariate power and tested within a multivariate framework on private firm data. The transformation of these variables is based directly on their univariate relations. That is, where they begin and stop adding to the final RiskCalc™ default rate prediction is not based on their raw level, but their level's correspondence to a univariate default prediction.

The functional form is often highlighted as the most salient description of the model (is it probit or logit?), but in fact, this distinction is far less important than two other modeling decisions: the variables used for estimation and the transformations of those independent variables. The variable selection process consists essentially of a step-forward procedure that starts with the most powerful univariate predictors of default for each risk factor (e.g., profitability). The method for transformations is less standard, but very straightforward.

Intuitively, the RiskCalc™ model for private companies uses a combination of univariate models -- the default frequencies corresponding to each input ratio -- within a generalized linear model; the weightings are based on the relative importance of each univariate model. The initial transformation reduces the problem to one amenable to linear modeling, while at the same time capturing the nonlinear effects of the individual ratios.

This approach is a simple extension of the common technique called 'minimodeling.' Consumer modelers have know for years that there is a bigger difference between 0 and 1, as opposed to 1 and 2, when looking at delinquency frequencies. Similarly, there's a bigger difference between increasing 10% in leverage from a base of 30% vs. a base of 70%. Calibrating these nonlinearities for individual ratios is the first step in model estimation.

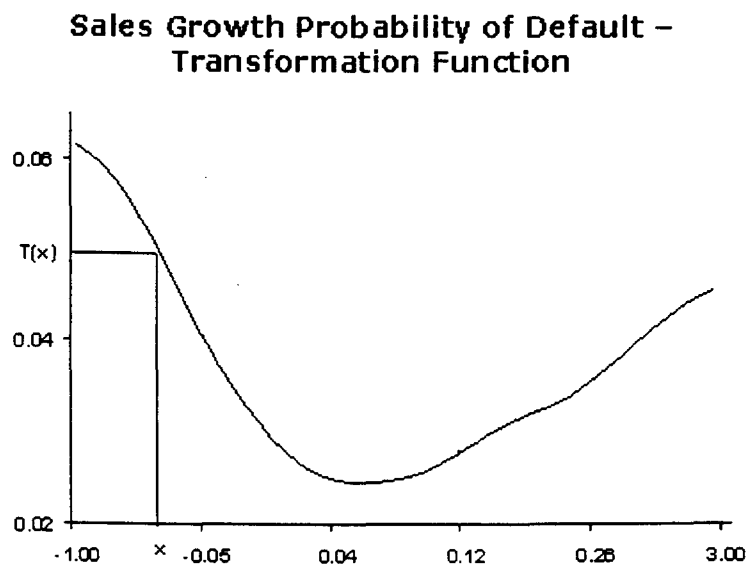
The ultimate model is a probit function that uses the transformation of the input variables within a Gaussian standard normal distribution, specifically:

$$\text{Prob}(\,default\,|T(x)) = \int_{-\infty}^{\beta T(x)} \frac{1}{\sqrt{2\pi}} e^{-\frac{(z)^2}{2}} dz = \Phi(\beta T(x))$$

Here, T(x) is a vector of functions that transforms the 10 input ratios, plus a constant term, where the transformations are basically the univariate relationship between each input and the future 5-year default frequency. Thus, for sales growth = -0.08 (i.e., -8%), we transform the data in the following way:

$$x = -0.08 \Rightarrow T(-0.08) = 0.049$$

This is done for all the input variables.



A lookup function maps raw ratios into values used within the probit model.

Moody's model for private companies performs better at anticipating defaults than a variety of models reported in the literature. We evaluated these alternative models using data from Moody's extensive proprietary default database and the credit model validation approach described in Sobehart, Keenan and Stein (2000). In the validation, we focus our attention on two Cumulative Accuracy Profiles (CAP) curves and Accuracy Ratios (AR). Tests were careful to use only out-of-sample performance to ensure the robustness of our results.